

REPARATION AND THE INTER-ALLY DEBTS IN 1931

by

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INTRODUCTION

WITHIN the past two years the size and character of a large part of the world's intergovernmental obligations have been changed materially. The Young Plan, designed to be a final settlement of the German reparation problem, was tentatively agreed to in June 1929, and after undergoing certain modifications at conferences at the Hague was put into actual operation on May 17, 1930.¹ It replaced the less definitive Dawes Plan, under which the reparation payments had been handled since 1924, and materially reduced the annual charges placed on Germany. At the same time, the intimate connection between reparation and the inter-Ally debt payments was at last recognized definitely in the very construction of the Young Plan annuity schedule, though the connection still remains a matter of fact rather than of formal statement.

EFFECTS OF THE DEPRESSION

It was commonly hoped that the adoption of the Young Plan, entailing as it did a diminution of Germany's burdens and the termination of a lengthy period of uncertainty, would lead to a new era of expansion and general prosperity. To date, this hope

has not been fulfilled. Even before the Young Plan negotiations were completed, a gradual downward movement began in the general business activity of the leading countries, and at present the world finds itself in the most widespread depression of the twentieth century. This depression has placed a severe strain on both parts of the intergovernmental payment mechanism: on the mechanism of Germany's payments to the creditor Allies, and on the mechanism of the Allies' payments to one another and to the United States.² In addition, the depression has materially altered the fundamental economic conditions which underlie the intergovernmental payments themselves. It has brought a decline in the level of prices and a rise in the value of money, and has thereby increased the real burden which the payments impose on the debtors. These developments make it appropriate to undertake an appraisal of the present economic status of the intergovernmental obligations themselves, and a summary examination of conditions and prospects in the principal debtor countries.

1. Cf. Harry D. Gideonse, "The Reparation Settlement of 1930," F. P. A. *Information Service*, Vol. VI, No. 5, May 14, 1930.

2. There are certain other intergovernmental obligations which cannot be classed under either of these two heads, but they are relatively small in size, and will not be considered here. Chief among them are the Bulgarian and Hungarian reparation and other charges, and the unfixed charge on Austria. Cf. National Industrial Conference Board, *The International Financial Position of the United States* (New York, 1929), p. 185.

GERMANY

The keystone of the present intergovernmental payment structure is Germany. Under the Young Plan and the accompanying agreements, Germany is scheduled to pay the European Allied powers, from 1930 to 1988, a total of over 26 billion dollars in reparation.³ These European creditor powers in turn owe large debts to one another and to the United States—debts which arose out of wartime and post-war loans. The only important net creditor in the inter-ally debt accounts, under the debt-funding agreements concluded to date, is the United States. In the period covered by the Young Plan (1930 to 1988), the European Allies are scheduled to pay the United States over 20 billion dollars. Out of the total payments which Germany makes to her creditors, the European Allies will therefore be able to keep only a little over 6 billion for their own use. The rest, or more than three-quarters of the scheduled total, will really be transferred to the United States. The surplus which the Allies receive will all be paid, however, in the first part of the period—in the years up to 1966; and in the present calendar year the Allies will receive 387 million dollars as reparation, whereas they must pay the United States only 228 million.⁴

In law there is still no formal connection between reparation and the inter-ally debt payments. But as a matter of practical finance and politics, most observers believe it extremely doubtful whether the European Allies would be willing to make their scheduled payments to the United States without first receiving the stipulated reparation annuities from Germany. Nor is it entirely certain that they would have the financial power to do so, even if willing. The Allied budgets are already burdened heavily, and it might prove difficult to secure any large additional surplus from them. In effect, therefore, the largest ultimate recipient of

3. In addition to reparation proper, Germany must also make payments abroad to cover the service of the Dawes Loan, army of occupation costs and mixed claims due the United States (738 million dollars), and the Belgian mark claims.

4. Of the surplus, much the largest part accrues to France, with Italy and Belgium receiving smaller shares. Great Britain also has a small surplus under the Young Plan; but if all British outpayments since the war be included, it is asserted that Great Britain would suffer a small net loss. Cf. Lewis Webster Jones, "The Young Plan Settlement," F. P. A. Information Service, Vol. V, No. 12, August 21, 1929.

the reparation annuities is really the United States, not the European Allies; in effect, the source of inter-ally debt payments to the United States is not the European Allies, but Germany.⁵ The critical keystone position of Germany is thus clear. What is Germany's own situation today?

BUSINESS CONDITIONS IN GERMANY

Germany reached the peak of her post-stabilization recovery and expansion in the middle of 1928. A mild recession followed, which was intensified by a severe strike in the Ruhr early in the winter of 1928-1929; and then, just when recovery might have been looked for, the negotiations over the Young Plan got under way. Whether rightly or wrongly, there was a great deal of uneasiness in world financial circles over the possible outcome of the negotiations. In consequence, it became extremely difficult for Germany to borrow abroad at reasonable terms, and in addition a good deal of foreign capital was temporarily withdrawn. These changes were a serious blow to German business. Further internal expansion was immediately checked, and an era of cumulative depression gradually got under way. Indeed, Germany was probably the first country to feel that downward trend in general business which has now become world-wide, and at present she is undoubtedly suffering more severely from the depression than any other important country except possibly England. Her wholesale price level has declined from the 1928 peak by some 20 per cent, the general volume of production by over 25 per cent, and the volume of imports (in Germany an excellent guide to anticipated business conditions) by nearly 30 per cent. Worst of all, Germany now has (March 1931) about five million unemployed—a fourth of all her available labor.⁶ The resulting strain on the federal

5. The direct receipts of the United States from Germany cover only army of occupation costs and mixed claims; the United States receives no share in Germany's reparation payments proper.

6. Cf. current issues of *Wirtschaft und Statistik*, and the *Vierteljahreshefte* of the Institut für Konjunkturforschung; also, U. S. Department of Commerce, *Commerce Reports* (Washington, Government Printing Office, weekly). German unemployment figures, however, must be interpreted in the light of other considerations as well. The elimination of most of the pre-war army and navy, in particular, has been an important factor in post-war unemployment.

finances has been a major cause of the recent series of budget deficits and crises.

In some directions, the current position is even worse than the summary figures just presented would indicate; in others it is distinctly better. The brightest spots on the horizon are the export trade and the condition of the leading export industries. During 1930, when the value of the foreign trade of the world as a whole was falling from the peaks of 1928 and 1929⁷ by 25 to 30 per cent, Germany's exports declined only 10 per cent in value; and when allowance is made for price changes, the decline in terms of physical quantities is less than 7 per cent. In the important electro-technical and chemical industries, this comparatively high level of exportation has nearly offset the decline in domestic business. Similar conditions have prevailed in the shoe industry. The paper industry has also held up fairly well; and textiles have suffered less than the average from the current depression. In the latter case, however, this is due to the fact that the textile groups as a whole have been depressed for some years past, and have adjusted themselves to a volume of demand far below capacity.

In the heavy industries, on the other hand, the depression has been felt severely. The production of coal and coke has declined 20 to 30 per cent since January 1930 and the production of pig iron, raw steel and rolled steel products 30 to 40 per cent; in all these cases the declines from the peaks of 1928 or 1929 are even greater. In the machinery and machine-tool groups the decline since January 1930 amounts to about 25 per cent; in the automotive group, to over 50 per cent. Glass and porcelain manufactures have also suffered severely, and in the building trades 40 per cent of the available labor was unemployed even at the midsummer peak. The latter situation seems unlikely to improve substantially for at least another year or two.⁸

STRAINS IN THE PRICE STRUCTURE: PRICES AND WAGE RATES

Even more serious than the distress in

particular divisions of industry has been the continued strain and distortion in the German price structure, and in the relation between prices and wages. With respect to price distortion, the essence of the situation can be summarized in the statement that the closer one comes to the final consumer, the greater has been the rise in German prices relative to pre-war levels, and the less has been the decline from the 1928 or 1929 peaks. Despite the severity of the depression, retail prices and the cost of living have thus far fallen but little (the cost of living only 7 per cent), and have declined much less than wholesale prices. Similarly, consumers' finished goods have fallen less than industrial finished goods, while finished goods as a whole have declined less than agricultural products, and raw materials produced at home much less than those produced abroad.⁹ Yet this does not mean that the average individual producer or distributor is securing undue profits; rather, it means that the German internal distribution system is still relatively inefficient. The excessive cartellization of German industry and trade, and the continued existence of over-organization of other sorts, has kept large numbers of high-cost firms in operation, and has prevented the transmission of the full benefits of declining raw material prices to the ultimate consumer.

This situation has been characteristic of the German economy since 1926. Its effect has been to constrict very seriously the domestic outlets for German products; and at a time when depression has reduced domestic purchasing power, it thus aggravates the internal depression itself. Export prices, on the other hand, have been reduced freely with the fall of raw material prices, with the result that the volume of German exportation has been remarkably well maintained in the face of adverse world-market conditions. It seems to be agreed by competent observers that this distorted price situation is one of the most dangerous factors in the present economic position of Germany.

The situation with respect to wages is similar to that with respect to the prices of

7. The decline was especially severe in the case of the United States. In January 1931, the dollar volume of our foreign trade was 40 per cent below the volume of January 1930, and was still farther below the peaks of 1928-1929.

8. *Commerce Reports*, cited, January 26, 1931, p. 214, 215.

9. Cf. *Vierteljahreshefte*, cited.

consumers' finished goods. Average wage rates rose steadily until the end of 1929 and remained unchanged until the closing months of 1930, when a decline at last began. At present various groups of producers, backed by the government, are attempting to enforce reductions. To date their success has been limited, however, and it is doubtful if average wages have yet fallen by as much as 5 per cent from the previous peaks. The high level of wages has had two undesirable consequences—it has interfered with efforts to reduce production costs and, not less serious, it has given manufacturers an additional incentive for reducing labor forces, and for not taking on new men. It has thus been an important factor in the unemployment crisis. The organized working classes have maintained their nominal wage rates,

but at the expense of their employment and their aggregate actual earnings. As a result, the country's internal purchasing power has been still further impaired, and the severity of the depression has been intensified. On the other hand, however, salary rates have been reduced substantially, and nearly all other classes of money income not fixed by contract—notably business profits—have fallen heavily.

FEDERAL FINANCES

The position of the federal finances naturally has followed closely the movement of business in the country at large. The summary figures on the federal finances proper since 1924 are presented in Table I. Figures cover only the *ordinary* budget; transfers to local governments are excluded.¹⁰

TABLE I
German Federal Finances—1924-1931
(IN MILLIONS OF MARKS)

| | 1924-25 | 1925-26 | 1926-27 | 1927-28 | 1928-29 | 1929-30 | 1930-31 | Actual first half 1930-31 |
|-------------------------------------|---------|---------|---------|---------|---------|---------|---------|---------------------------------|
| Income (ordinary) | 4,793 | 4,595 | 5,061 | 5,931 | 6,218 | 6,807 | 8,235 | 3,599 |
| Expenditures (ordinary) | 3,725 | 4,232 | 5,288 | 5,807 | 6,819 | 7,253 | 8,300 | 4,054 |
| Current Surplus or Deficit | + 1,068 | + 363 | — 227 | + 124 | — 601 | — 446 | — 65 | — 455 |

Ever since the fiscal year 1925-1926, the consolidated federal budget has shown an ominously large current deficit. Last year really serious efforts were made to bring the situation under control by increasing taxation and by pruning expenditures, but the cumulative depression in business at large has made the efforts vain thus far. Current tax yields have fallen off considerably,¹¹ while expenditures have increased heavily because of unemployment insurance deficits. The unemployment insurance machinery, already in difficulties two years ago, proved wholly incapable of carrying the enormous and unexpected load of the present depression, and the federal government had to take over much of the excess burden. Yet even with the borrowing which this situation has made

necessary, current gross receipts have run behind current expenditures during much of the past year, leaving a small current deficit. The strong and courageous policy of the present government, however, justifies the general belief that a solution will be found as soon as business revival, by diminishing the drain for unemployment subsidies and by increasing tax yields, creates the conditions which will make a rectification of the budget position possible.

FEDERAL FINANCES AND REPARATION PAYMENTS

It should be emphasized in this connection that the current crisis in federal finances is not itself directly attributable to reparation. It is true that under the Young Plan the whole of the reparation charges falls on the federal budget, whereas under the Dawes Plan only a part of them were met in this way; and it is true, therefore, that the nominal burden on the budget has been increased. But this increase is at present more

10. Deficits in the extraordinary budgets have caused actual current deficits in the consolidated federal finances in every one of these years except 1924-1925. Data for 1924-1929 from the *Report of the Agent-General for Reparation Payments for May 21, 1930*, p. 104; for 1929-1931, from *Wirtschaft und Statistik*, cited.

11. Cf. *Wirtschaft und Statistik*, cited.

than offset by the decrease in the size of the annuities themselves, and by the assignment to the budget of a tax on the Federal Railway system which is equal to the income from the old Railway Bonds. The direct charge for reparation on the German taxpayer is hence actually less now than it was under the Dawes Plan.¹² Reparation charges formed 18.4 per cent of the total federal expenditures (excluding transfers to local governments) in 1929-1930, and 19 per cent of the estimated expenditures for 1930-1931. The social charges alone, it is interesting to

note, were almost as large: 14.8 and 15 per cent, respectively. The present reparation charge amounts roughly to \$6.25 a year on every man, woman and child in Germany.

It would be illuminating to compare the total present tax burden in Germany with similar burdens in other countries, but the lack of reliable recent data makes such comparisons impossible in some cases, and of dubious value in others. Summary estimates for certain available years, including local as well as central government costs, are given, however, in Table II.¹³

TABLE II
Comparative Governmental Costs

| Country and year | | In dollars per capita | As per cent of national income |
|----------------------------------|-------|--------------------------|-----------------------------------|
| Germany, 1928 or 1928-1929 | | 65.51 | 27.3 |
| Great Britain, 1924 or 1924-1925 | | 97.35 | 22.2 |
| France, 1927 | | 57.30 | 26.4 |
| Italy, 1925 or 1925-1926 | | 20.70 | 14.8 |
| Belgium, 1926 | | 31.40 | 19.5 |
| United States, 1927 | | 77.50 | 11.8 |

INTERNATIONAL COMMERCIAL AND FINANCIAL SITUATION

Germany's international commercial and financial position has been much less unfavorable during the past year or more than her internal situation. In every month but

two since August 1929, Germany has had a substantial surplus of exports, averaging over 30 million dollars a month and recently running as high as 60 million. The figures for Germany's foreign merchandise trade alone, since 1924, are given in Table III.¹⁴

TABLE III
German Foreign Trade in Merchandise, 1924-1930
(IN MILLIONS OF MARKS)

| Year | Imports | Exports | Balance |
|-----------------|---------|---------|---------|
| 1924 | 9,083 | 6,552 | -2,531 |
| 1925 | 12,362 | 9,290 | -3,072 |
| 1926 | 10,001 | 10,414 | + 413 |
| 1927 | 14,228 | 10,801 | -3,427 |
| 1928 | 14,001 | 12,276 | -1,725 |
| 1929 | 13,446 | 13,483 | + 37 |
| 1930 (estimate) | 10,700 | 12,300 | +1,600 |

Except for a few months in 1926, exports have not consistently exceeded imports, until recent months, since the currency stabilization in 1924. Final figures are not yet avail-

able, but the indications are that the export surplus for 1930 will be close to 400 million

14. Summary figures from U. S. Department of Commerce, *Commerce Yearbook 1930* (Washington, Government Printing Office, 1930), Vol. II, p. 250; preliminary estimate for 1930 based on partial figures in *Vierteljahrsshefte*, cited. The balances do not agree with those in Table IV, item 1 (cf. p. 89), because the latter figures cover ship sales and other transactions, whereas the figures here are for merchandise only.

These figures cover exports, including reparation deliveries in kind, of German products only; and imports for consumption only. Gold bullion and coin are excluded.

12. *Ibid.*

13. Cf. James W. Angell, *The Recovery of Germany* (New Haven, Yale University Press, 1929), p. 317, 333.

dollars.¹⁵ This surplus will virtually cover Germany's reparation payments for the current year.

Some students have inferred from the present situation that the reparation transfer problem can now be regarded as solved. A closer examination, however, casts doubt on that conclusion. As pointed out already, the total volume of Germany's exports has actually *declined* during the present year as compared with 1929.¹⁶ The export surplus is due primarily to the more rapid decline of German imports, which are now at the lowest levels since 1926, and at hardly two-thirds of the 1928 and 1929 peaks.

What does this decline in imports mean? Most observers agree that it represents neither any permanent lessening of Germany's dependence on foreign products, nor any guarantee that a favorable trade balance can be maintained at the present levels. Rather, in the main, the import reduction reflects nothing more than the decline in Germany's general business activity. In recent years an average of 83 per cent of all German imports has consisted of foodstuffs, raw materials and half-finished products, while 50 per cent has consisted of raw materials and half-finished products alone.¹⁷ Moreover, it has been estimated that in the six principal industrial groups combined (which are also the principal exporting groups), 55 per cent of all the raw material consumed is imported; and that for every three dollars' worth of products these industries export, two dollars' worth of foreign raw materials must first be imported.¹⁸

These facts clearly indicate that the decline in the volume of imports cannot well prove permanent, if the recent levels of German production, exportation and standard of living are to be restored; and they hence suggest that at least a good deal of the present export surplus will disappear when Germany's business activity revives. This inference draws support from the German trade statistics in recent years: the trade balance has moved typically in a

favorable direction when a domestic business depression was developing, or was in process. It is possible, however, that a re-orientation may be taking place with respect to the provision of German industry with raw materials.

GERMAN GOLD STOCKS AND FOREIGN CREDIT

Other aspects of the international financial situation also have been comparatively favorable during much of the last year or two, if allowance is made for the existence of depression in the rest of the world. It is true that the Reichstag elections in September 1930, and the success of the two extreme parties,¹⁹ precipitated a loss of confidence both at home and abroad, and it is estimated that some 250 million dollars of foreign and domestic capital was exported in the next few weeks.²⁰ The Reichsbank itself lost over 100 million dollars in gold. But the tide was soon stemmed, a return flow of gold and capital began, and the general international position is fairly easy at present. All foreign obligations, whether private or for reparation account, have been met punctually, and before the September 1930 Reichstag election the Reichsbank had been gaining gold steadily. Finally, and perhaps most important, foreign borrowing has been resumed in fairly substantial though intermittent volume. Despite the depressed condition of the world markets, it is estimated that Germany secured some 525 million dollars gross of foreign funds abroad in 1930, whereas in 1929 she had managed to raise only 80 million.²¹ Although an important part of the recent foreign financing was both governmental and of short-term character (private borrowing being relatively small in amount), the proceeds undoubtedly will help materially in supporting the re-

19. Cf. M. S. Wertheimer, "The Hitler Movement in Germany," F. P. A. *Information Service*, Vol. VI, No. 23, January 21, 1931.

20. Cf. *Commerce Reports*, cited, January 26, 1931, p. 215.

21. *Ibid.*, January 26, 1931, p. 216. The German portion of the Young Plan international loan (one-third of the nominal total of 300 million dollars), and the proceeds of the Kreuger loan to the Reich, are included in the figure for 1930. Similarly Dr. Max Winkler puts Germany's long-term foreign borrowing alone (exclusive of short-term financing and "direct" foreign investment in Germany) at about 335 million dollars for 1930. (Cf. *New York Times*, March 8, 1931, and Dr. Max Winkler, "America's Stake Abroad," F. P. A. *Information Service*, Vol. VI, No. 24, Part II, February 4, 1931.) It must be remembered, however, that these estimates are gross. They make no allowance for withdrawals of foreign capital from Germany during the year, nor for German investments abroad.

15. Cf. *Vierteljahreshefte*, cited, and *Commerce Reports*, cited, January 26, 1931, p. 215.

16. Cf. p. 87.

17. Cf. Angell, *The Recovery of Germany*, cited, p. 293.

18. *Ibid.*, p. 181.

vival of business when it gets under way. They have already prevented the volume of commodity imports from dropping to levels even lower than those thus far reached, and have enabled Germany to lay in large stocks of foreign raw materials purchased at low prices.

PUBLIC AND PRIVATE PAYMENTS CURRENTLY DUE ABROAD

In order to estimate Germany's present international financial position correctly, it is necessary also to take account of the current payments which must be made abroad against prior foreign borrowing, and against reparation. The total private investment of foreigners in Germany, taking long-term and short-term placements together, is now approximately 5 billion dollars. After subtracting Germany's own relatively small foreign investments, the *net* payment Germany must make abroad as interest, profits and amortization charges on this foreign capital amounts to over 250 million dollars a year—possibly 275 million.²² In addition, the reparation annuities for the current fiscal year, plus the payments to the United States and other charges, come to over 400 million dollars. The two items together—reparation and the payments to foreign private investors—total roughly 660 to 675 million. Furthermore, these items will inevitably increase—reparation in accordance with the Young Plan schedules, and the private payments whenever Germany again borrows abroad.

These figures represent the irreducible

minimum which Germany must pay abroad each year, at least for some time, if she is to meet her obligations. These payments she can make in three ways only: (1) by exporting a net surplus of commodities; (2) by exporting a net surplus of services—services to tourists, brokers' services, freights and the like; or (3) by borrowing abroad. The service surplus is still comparatively small. The commodity surplus has been large enough in the past year to cover rather more than half of the total payments due, taking reparation and private debt payments together; but grounds have been suggested for fearing that a surplus of the present size is unlikely to be maintained.²³ Finally, borrowing abroad has the fundamental drawback that it is not a permanent solution of an international-payment problem. Interest has to be paid on the new borrowings as well as on the old, and in subsequent years the payment problem as such becomes worse, therefore, than it was before. Moreover, between a quarter and a third of all the foreign capital now in Germany is at short term.²⁴ There is hence nothing controversial in the statement that the German international financial situation is still extremely precarious.

The general character of Germany's international financial situation can be gauged from Table IV, showing the net balances of the principal items in Germany's international payments since 1927. The figures are from official sources; and as remarked already, it is believed that they under-estimate the size of the capital movements.²⁵

TABLE IV
Germany's Balance of International Payments Since 1927: Net Items
(IN MILLIONS OF MARKS)

| Item | 1927 | 1928 | 1929 | 1930 | |
|---|--------|--------|--------|-----------|-----------|
| | | | | Jan.-June | July-Oct. |
| 1. Commodity trade, ship sales, etc. | -2,960 | -1,285 | - 47 | + 458 | + 719 |
| 2. Gold and bills | + 452 | - 931 | + 162 | - 390 | +1,092 |
| 3. Services | + 512 | + 480 | + 530 | + 150 | + 159 |
| 4. Total commodities and services | -1,996 | -1,736 | + 645 | + 218 | +1,970 |
| 5. Reparation payments | -1,584 | -1,999 | -2,501 | - 629 | - 624 |
| 6. Private interest, profits, etc. | - 345 | - 563 | - 873 | - 500 | - 330 |
| 7. Total payments on obligations | -1,929 | -2,562 | -3,374 | -1,129 | -- 954 |
| 8. Long-term loans and credits | +1,210 | +1,268 | + 176 | + 730 | + 228 |
| 9. Short-term capital movements | +1,779 | +1,335 | +1,152 | + 194 | + 355 |
| 10. Miscellaneous capital movements | + 936 | +1,695 | +1,401 | - 13 | -1,599 |
| 11. Total capital movements | +3,925 | +4,298 | +2,729 | + 911 | -1,016 |
| 12. Balance, items 4 plus 7 plus 11 | 0 | 0 | 0 | 0 | 0 |

PRESENT ECONOMIC POSITION

If we now take the present German economic situation as a whole, the two brightest spots are clearly the foreign trade position and the strong financial program of the federal government. The fact that German exports have held up so well in the face of world-wide depression is a high tribute both to the energy of the German foreign sales organizations and to the success of the manufacturers in meeting foreign competitive conditions, and it augurs well for the future. The financial program of the federal government has commanded confidence both at home and abroad, and, although it cannot be expected to yield definitive results until a revival of business has increased tax yields and has diminished unemployment, adherence to the program seems likely to bring success.

The darkest spot is the very fact of business depression. There are other sources of strain and pressure, however, which are of a more fundamental sort and which will almost certainly prove more enduring. The business depression has probably already passed its low point, but these underlying strains will not be thereby removed. Despite the progress registered in the last few years, Germany is still highly dependent on foreign supplies of foodstuffs and raw materials, on foreign markets for her manufactured products, and on new foreign loans with which to meet a considerable part of her current international obligations. Nor does this three-sided dependence seem likely to disappear permanently in any very immediate future.

These latter considerations emphasize the fundamental paradox of the present inter-governmental payment situation itself. This paradox is the fact that the creditors insist that payment shall be made, yet at the same

22. The present writer believes that the Federal Statistical Office and the semi-official Institut für Konjunkturforschung still under-estimate the present size of the foreign investment in Germany, and hence the volume of annual payments abroad. Cf. Angell, *Recovery of Germany*, cited, p. 302, 303.

23. Cf. discussion on p. 88.

24. Cf. the *Report of the Agent-General for Reparation Payments for May 21, 1930*, p. 216; also Angell, *Recovery of Germany*, cited, p. 303.

25. Data from *Vierteljahreshefte*, cited. Items unaccounted for, errors, etc., are apparently lumped in item 10. For a summary estimate of the total balance of payments position from 1924 to 1928, cf. Angell, *Recovery of Germany*, cited, p. 303. This latter estimate indicates that some 80 per cent of Germany's net balances of payments due abroad in that period was met by borrowing.

time are unwilling to receive payment. But all efforts to secure a general reduction in the present high levels of the world's tariff schedules and other trade restrictions have thus far been conspicuously unsuccessful; and, in considerable part as a direct consequence, Germany is still a persistent borrower abroad.

Most students are agreed that neither the present depression nor Germany's present surplus of exports has materially changed the character of these underlying controlling factors. It is still true, as it was before the depression, that the larger part of Germany's private debt and public reparation payments abroad, taking one year with another, are being met out of the proceeds of foreign borrowing. Although the commodity surplus will be close to 400 million dollars for 1930, total foreign borrowings are estimated at 525 million.

THE PRICE LEVEL AND REPARATION

Finally, another phase of the reparation problem which has only recently begun to attract general attention may prove even more important. It arises from the fact that the Young Plan contains no provision for adjusting the reparation annuities to changes in the value of money. A provision of this sort was incorporated in the Dawes Plan, but for a number of reasons was omitted from the Young Plan.²⁶ At present the German wholesale price level is at least 15 per cent below the levels which were prevailing at the time the Young Plan was drawn up; and although nominal wage rates have remained high, employment has declined severely, and actual money incomes in the country at large have probably fallen at least as much as prices.

But the reparation annuities remain unchanged. It therefore takes more human effort to produce a dollar's worth of reparation now than it did when the Young Plan was formulated. Even if it be granted that the Young Plan annuities could be met under the conditions which prevailed when the

26. On the Allies' side, it would evidently be impossible to issue marketable bonds—to "commercialize" the reparation receipts—against variable annuities. On the German side, Germany expected prices to rise, and hence expected to benefit from the omission.

Plan was drawn up, it clearly does not follow that Germany can carry the present burden, which at the moment is some 15 to 20 per cent heavier than was originally intended.²⁷ If the present levels of prices and money incomes prove more or less permanent, this problem may well assume serious dimensions. It seems unlikely to produce any sudden crisis, but the continuous pressure on the German budget, on the German standard of living, and on German productive capacity may gradually come to be thought unreasonably severe. A further revision of the reparation schedules may then be found necessary.

GERMANY'S PRESENT POSITION AND REPARATION: SUMMARY

Germany's current situation with respect to her reparation obligations can therefore be summarized as follows. First, the combination of renewed foreign borrowing and a large excess of commodity exports has given her command, for the time being, of more than the requisite quantities of foreign exchange, so that her present international financial position is comparatively easy. Whether the export surplus can be permanently maintained at its present level, however, is evidently open to question. At the same time, the large proportion of the foreign debt which is at short term makes Germany's present international ease rather precarious, and in one sense specious. Second, the internal budget position of the *Reich* is seriously impaired at the moment, but this impairment is due to the increased burden of the unemployment insurance contributions, not to the reparation charges; the net burden of reparation charges on the budget is actually less now than it was last year. The revival of business may be expected to correct the situation. Third, in

the event that anything like the present levels of prices and money incomes are maintained permanently, the real burden of the reparation charges will prove to have increased proportionately; and at some future date it may then become necessary to reconsider the present annuity schedules themselves.

Most observers agree, however, that the influence of this last factor will be seriously felt only over a period of time, if it is felt at all. They believe it unlikely that any revision of the reparation schedules will become economically necessary in the immediate future, and still less likely that Germany will herself declare a moratorium in the next year or two. The large size of Germany's present foreign indebtedness at short term, and the virtual certainty that she will have to continue borrowing considerable sums abroad for some time to come, would make any such step extremely dangerous, for it would seriously impair the whole basis of Germany's credit. This general view is confirmed by the recent conclusive pronouncements of the president of the Reichsbank, on March 1, 1931.²⁸ An enduring increase in the burden placed on Germany will develop only if the present levels of prices and money incomes prove more or less permanent. On the probabilities in that direction, informed opinions differ widely, and experience alone can clarify the issue.

One other factor in the situation must also be borne in mind. The ultimate ground for the exaction of reparation payments is the postulate of Germany's war guilt.²⁹ Most Germans, and many impartial students in other countries, now regard that hypothesis as disproved. It is, therefore, entirely possible that a cogent general movement for revision will develop quite independently of economic considerations, and based solely on the politico-ethical aspects of the reparation problem.

27. The burden is heavier not only in consequence of the decline in world prices (declines which have been even greater in certain other leading countries than in Germany), but in consequence of the probably more than proportionate fall in the yield of any given rate of taxation. The latter phenomenon may prove only temporary, but there is some ground for thinking that it may persist.

It is also sometimes asserted that the increase in the real burden placed on Germany is more or less offset by the advantage she is now gaining from the fall in prices of raw materials, a large part of which is purchased abroad. But evidently that advantage is likely to be only temporary. It can continue only as long as the decline in raw material prices remains greater than in proportion to the decline in the domestic and foreign prices of Germany's manufactured products; that is, only as long as the price situation in general remains out of balance. Any substantial decline in the prices of finished goods, or any substantial rise in the prices of raw materials, would wipe out the advantage.

28. According to *Le Temps* (Paris) of March 3, 1931, Dr. Luther said in part: "Germany will hold to its commitments, but it is essential that its partners recognize theirs. In any case, there will be no question of the suspension of payments on private debts; the service of the Dawes loan and the Young loan will be assured even though Germany should demand a moratorium for its public obligations under the Young Plan provisions." Cf. also, *New York Times*, March 3, 1931.

29. The text of Article 231 of the Treaty of Versailles is as follows: "The Allied and Associated Governments affirm and Germany accepts the responsibility of Germany and her allies for causing all the loss and damage to which the Allied and Associated Governments and their nationals have been subjected as a consequence of the war imposed upon them by the aggression of Germany and her allies."

THE EUROPEAN CREDITORS

The general position of the leading European countries other than Germany is varied. England has been about as hard hit by the depression as has Germany. France has begun to suffer at all severely only in recent months. Italy falls somewhere between France and England. Underlying the depression in all three countries there is, as in the case of Germany, an enduring strain, or a complex of strains, which will not disappear when the depression has passed. It is necessary to have at least a summary knowledge of these strains to understand clearly the general economic setting of the intergovernmental obligations as they stand today.

ENGLAND

England has thus far suffered more severely from the present depression than any leading European country except Germany.³⁰ By the end of 1930, allowing roughly for seasonal variations, the British wholesale price level had dropped about 25 per cent and the physical volume of production 18 to 20 per cent, imports 20 per cent and exports 30 per cent, as compared with the 1929 peaks.³¹ This decline may prove comparatively temporary, but beneath it lies a strained economic situation of a more permanent and even more serious character. Three interrelated sets of conditions, among many others, seem to be dominant. One is the enormous size of the public debt, itself primarily a heritage of the war. The British debt amounts to some 37 billion dollars. It is the largest public debt in the world, and measured on a per capita basis is six and one-half times as big as ours.³² Its service consumes nearly half the public revenues, and has been a major factor in making the real burden of taxation in Great Britain likewise one of the heaviest in the world.

The second factor has been the striking failure of British industry to adjust itself completely to post-war conditions, either in its methods or in its products. Before the war, British industry had been built primarily around coal, iron and steel, and tex-

tiles, for all of which there were large export markets; and it had been highly individualistic in its internal organization. After the war the export markets for these products fell off considerably, while the increasing severity of world competition placed a premium on improved forms of industrial organization. British industrialists as a whole were slow to perceive the changes that were taking place, however, and had difficulty in developing new products which they could sell abroad. Moreover, until recently they were singularly unwilling to cooperate with one another in the solution of their problems. The series of crises in the cotton industry, in coal, and in the machinery trades, are familiar illustrations of the effects of the general maladjustment. The resulting restriction of Great Britain's exporting power has had all the more serious consequences for the general national welfare, because the loss of much of its pre-war foreign investment and the impairment of its position as the financial center of the world have likewise reduced its current income from foreign countries. To a nation as highly dependent on foreign supplies of foodstuffs and raw materials as is Great Britain, these changes cannot be anything but grave.

Finally, and in considerable part the product of the first two factors, there is the tragic, vicious circle of unemployment. Unemployment has been chronic in Great Britain ever since the demobilization, but it has been greatly intensified by post-war conditions. When a country is already suffering from limited production and high taxes, employment is limited and even reduced, with a consequent lowering of domestic purchasing power and hence decreased domestic sales and production. Moreover, the unemployed must be supported, by insurance or otherwise. England now has approximately two and one-half million unemployed workers³³—a fifth of its whole industrial population.

Relevant data on Great Britain's governmental receipts and expenditures and on foreign trade are presented in Table V.

30. For comparative description of conditions in the United States, cf. p. 95.

31. Cf. Royal Economic Society, *Report on Current Economic Conditions*, January 1931.

32. Measured on the basis of average individual income, it is approximately ten times as big.

33. The latest available figure is 2,580,000. Cf. *New York Herald Tribune*, April 10, 1931.

TABLE V
Summary Figures on British Economic Conditions

| A. GOVERNMENT RECEIPTS AND EXPENDITURES (IN MILLION POUNDS) ³⁴ | | | | | |
|---|-------------------|-------------------|-------------------|------------------------|-------------------|
| | Actual 1926-27 | Actual 1927-28 | Actual 1928-29 | Preliminary 1929-30 | Budget 1930-31 |
| Total receipts | 805.7 | 842.8 | 836.4 | 734.2 | 739.6 |
| Total expenditures | 842.4 | 838.6 | 818.0 | 748.7 | 781.9 |
| Surplus or deficit | — 36.7 | + 4.2 | + 18.4 | — 14.5 | — 42.3 |
| B. FOREIGN TRADE (IN MILLION POUNDS); PRODUCTION INDEX ³⁵ | | | | | |
| | 1926 | 1927 | 1928 | 1929 | 1930 |
| Net imports | 1,116 | 1,095 | 1,076 | 1,112 | 957 |
| Domestic exports | 653 | 709 | 724 | 730 | 570 |
| Balance | — 463 | — 386 | — 352 | — 382 | — 387 |
| Production index: | | | | | |
| 1924=100 | 75.7 | 108.1 | 102.5 | 110.6 | 98.7 |

FRANCE

France, on the other hand, has begun to feel the depression at all seriously only in the last few months. The general average decline in economic activity has thus far amounted to only about 10 per cent. Far less dependent than England on foreign markets for her products, or than Germany on foreign raw materials, France's public debt is hardly two-fifths as big as England's; and until very recently the country has had no unemployment. In addition, large investments and short-term balances abroad have given France much the biggest gold reserve in Europe.

The element of major strain in the French position arises from the public finances, on which figures are given in Table VI.

France's total budget is substantially as large as Germany's, though smaller than England's; and the real tax burden, measured on the basis of average individual income, is as heavy as that of either England or Germany. Three groups of items account for substantially half of France's total expenditures; they are, in order, debt service, national defense, and pensions and related charges. Defense alone, according to the published statements, accounts for 22 per cent of the total.³⁶ Besides these definable burdens, France is still suffering to some extent from the shifts and losses of wealth consequent on the depreciation and re-valuation of her currency.³⁷ Taking its position as a whole, however, France has been less affected by the world depression than any other leading European country.

TABLE VI
Summary Figures on French Economic Conditions

| A. GOVERNMENT RECEIPTS AND EXPENDITURES (IN MILLION FRANCS) ³⁸ | | | | |
|---|----------|----------|----------|----------------|
| | 1927 | 1928 | 1929 | Budget 1930 |
| Total receipts | 50,067 | 53,295 | 58,561 | 50,465 |
| Total expenditures | 39,541 | 42,445 | 45,366 | 50,398 |
| Surplus or deficit | + 10,526 | + 10,850 | + 13,195 | + 67 |
| B. FOREIGN TRADE (IN MILLION FRANCS): PRODUCTION INDEX ³⁹ | | | | |
| | 1927 | 1928 | 1929 | 1930 |
| Net imports | 52,996 | 53,436 | 58,285 | (43,765) |
| Domestic exports | 55,196 | 51,375 | 50,072 | (36,163) |
| Balance | + 2,200 | — 2,061 | — 8,213 | (— 7,602) |
| Production index: | | | | |
| 1913=100 | 110 | 127 | 139 | (142) |

ITALY

Italy's present condition lies somewhere between that of France and England. Although its population is about the same as that of the first two countries, Italy is economically much weaker, for it is poor in the natural resources of industry, and even in arable land. Like Germany, Italy is therefore highly dependent on foreign raw materials and foodstuffs, and on foreign markets for the sale of its manufactured products. Italy also has large foreign debts, both public and private; and the "real" tax burden (measured on the basis of average individual income), though lighter than that of the other three leading European countries, is

much heavier than that of the United States. Italy's general economic position is therefore one of considerable chronic strain. But despite great vulnerability, especially from the international economic point of view, Italy has not been as hard hit by the depression, at least to the present time, as have Germany and England. Wholesale prices have fallen about 20 per cent in the past year, as has export trade, but the limited evidence available indicates that the general volume of domestic production is holding up fairly well, and is even showing some signs of recovery. Data on Italian governmental finance and on foreign trade are presented in Table VII.

TABLE VII
Summary Figures on Italian Economic Conditions

A. GOVERNMENT RECEIPTS AND EXPENDITURES (IN MILLION LIRE)³⁴

| | 1926-27 | 1927-28 | Budget | Budget |
|--------------------|---------|---------|---------|---------|
| | | | 1928-29 | 1929-30 |
| Receipts | 21,450 | 20,072 | 17,643 | 18,571 |
| Expenditures | 21,014 | 19,574 | 17,474 | 18,313 |
| Surplus | + 436 | + 498 | + 169 | + 258 |

B. FOREIGN MERCHANDISE TRADE (IN MILLION LIRE)³⁵

| | 1926 | 1927 | 1928 | 1929 | 1930 |
|------------------------|---------|---------|---------|---------|-----------|
| Net imports | 25,879 | 20,375 | 21,920 | 21,300 | (14,500) |
| Domestic exports | 18,665 | 15,634 | 14,559 | 14,889 | (10,100) |
| Balance | - 7,214 | - 4,741 | - 7,361 | - 6,411 | (- 4,400) |

SUMMARY

In summary, these other leading European countries, which are also Germany's principal intergovernmental creditors, are themselves suffering from fundamental economic strains which have been intensified by the present depression, but which existed long before the depression and will persist after it ends. The strains are least serious in the case of France, most serious in the case of England.

34. Data from *Commerce Yearbook, 1930*, cited, Vol. II, p. 584. For estimated comparative tax burdens, cf. Table II, p. 87.

35. Data for foreign trade from *ibid.*, p. 579; for 1930, Royal Economic Society, *Report on Current Economic Conditions*, January 1931, p. 15. For index of production, cf. Royal Economic Society, *Report on Current Economic Conditions*, cited. The effect of the coal strike of 1926 is evident. The index for the last quarter of 1930 was 93.5.

36. Comparable figures on the proportion of the budgets of other countries set aside for national defense are: Germany, 8.5; Great Britain, 14; Italy, 25 and the United States, 23.5. For Germany national defense includes the cost of national police forces.

The bearing of these strains on the problem of the intergovernmental obligations of the countries concerned is evident. At present, the annual payments which England, France and Italy receive from Germany on reparation account are much more than equal to the payments which these countries must make to the United States on inter-

37. France also exhibits that disparity in the recent movements of wholesale prices as compared with retail prices, which was noted in the case of Germany, but in France the undesirable consequences have been much less conspicuous.

38. Data from *Commerce Yearbook, 1930*, Vol. II, p. 238. For estimated comparative tax burdens, cf. Table II, p. 87. On April 1 the French budget for 1931-1932 was adopted with a surplus of only 3 million francs. Cf. *New York Times*, April 2, 1931.

39. Data on foreign trade from *ibid.*, p. 234; for 1930, first 10 months only. Data on production from *Statistique générale de la France*; for 1930, first 9 months only.

Cf. also *Commerce Reports*; the *Federal Reserve Bulletin*; and the *Economist*, February 14, 1931, supplement.

40. Data from *Commerce Yearbook, 1930*, Vol. II, p. 335. Borrowing, repayment of loans, and new investments are excluded.

41. Data from *ibid.*, p. 331; for 1930, first 10 months only. Cf. also, on Italian economic conditions, *Commerce Reports*; the *Federal Reserve Bulletin*; and the *Economist*, February 14, 1931, supplement; for estimated comparative tax burdens, cf. Table II, p. 87.

Ally debt account. But if the receipts from Germany were to be seriously diminished or to cease, part or all of the burden of the net inter-Ally debt payments to the United States would then fall directly on the budgets of the European Allies. In such an event,

that a reconsideration of the inter-Ally debt schedules themselves would be suggested is evidently not beyond the bounds of probability. Germany's economic welfare is therefore clearly vital to the financial balance of all Europe.

THE UNITED STATES

When the present position of the four leading European countries is compared with that of the United States, which is much the largest net creditor in the inter-governmental accounts, some striking similarities are revealed, and some even more striking differences. The similarities relate to the severity and scope of the current business depression; the differences relate to the underlying economic strains, which play so dominant a rôle in the European countries and which are so conspicuously absent in the United States.

OUR CREDITOR POSITION IN INTERNATIONAL FINANCE

The down-turn of general business in the past year or two has been as drastic in the United States as in England and Germany. Even with allowance for seasonal variations, by the beginning of 1931 our wholesale prices had fallen more than 20 per cent below the previous peaks, and production by 35 per cent; foreign trade had declined even more; competent authorities have thus far been quite unable to agree as to just how many millions of workers have been unemployed; and the collapse of the security markets, apart from such direct losses as it entailed, has imperiled the stability of countless banks and financial houses. Most observers agree, however, that the recent developments constitute only a relatively temporary reaction in the general upward movement of American business and prosperity.

Nor is there any evidence that American economic life is being carried on under such deep-seated and persistent strains, either domestic or international, as characterize the present position of the principal European countries. On the contrary, the United States is the ultimate beneficiary of certain conditions which are now producing financial strain in the European countries.

The latter conditions arise, of course, from the payments which the European countries are obligated to make currently to our private investors and to the American government. Our private citizens have now made investments and other advances abroad of some 17 billion dollars or more, chiefly since the war. The income from this huge sum now amounts to about 1,000 million a year. Of the total investment, about 30 per cent is in Europe; and Europe is now paying us around 360 million a year gross on private account. In addition, there are the inter-Ally debts (excluding the unfunded obligations of Armenia and Russia), with a total nominal principal of 11,400 million dollars, and a so-called "present value," at 5 per cent compound interest, of some 6,600 million. In the current year they will yield us, together with our small direct receipts from Germany, roughly 240 million dollars. This latter sum will grow steadily, under the present schedules, until it reaches a maximum of 415 million in 1933. If the two sets of European payments, private and governmental, are taken together, they now amount to some 600 million dollars a year gross.⁴²

The strain which these payments produce is not only the strain of raising the payments, but also the strain of transmitting the proceeds to the United States. The high American protective tariff makes it difficult

42. In 1929 our receipts from Europe from long-term investments were estimated at 272 million dollars; from short-term credits and advances, at 75 million; from war debts, at 207 million; the total was 554 million. Against this we made payments to Europe, on the first two counts, of 300 million, leaving a credit balance of 254 million. Figures for 1930 are not yet available; while we increased our long-term investment, we also probably withdrew short balances. Data for 1929 from *Commerce Reports*, cited, October 6, 1930.

On American foreign investment in general, cf. U. S. Department of Commerce, "The Balance of Payments of the United States in 1929," (*Trade Information Bulletin*, No. 698); the *Federal Reserve Bulletin*; "America's Stake Abroad," cited; and James W. Angell, "America's Rôle in the International Economic Situation" (*Proceedings of the Academy of Political Science*, January 1931), p. 71, 72. Foreign capital issues in the United States in 1930 totalled 905 million dollars gross.

For the inter-Ally debt and the reparation schedules, cf. Lewis Webster Jones, "The Young Plan Settlement," F. P. A. *Information Service*, Vol. V, No. 12, August 21, 1929; Harry D. Gideonse, "The Reparation Settlement of 1930," *ibid.*, Vol. VI, No. 5, May 14, 1930; also, Denis P. Myers, *The Reparation Settlement* (Boston, World Peace Foundation, 1929).

for the European debtors to sell their products—chiefly manufactured goods—directly in our markets; and the general high level of the existing tariffs in many other parts of the world makes the whole problem of profitable exportation much more difficult than it was before the war.

THE STATUS OF PAYMENTS DUE US FROM EUROPE

Europe's payments to the United States on private debt account will presumably give rise to no serious problems. In the main, the money originally secured from the United States has been employed, directly or indirectly, for so-called "productive" purposes, and it can therefore be assumed that the consequent general increase in Europe's productive powers is providing the funds with which to meet the payments currently falling due.

The European payments to us on governmental account are another matter. The money originally secured from us was used, in largest part, not for productive purposes but to carry on the war. It was used to purchase American products, in many cases at "profiteering" prices, which were in largest part either blown up or eaten up, and its expenditure, therefore, failed to bring about any parallel increase in Europe's productive powers. Hence the governmental payments to us are a net addition to the burden on the European taxpayers concerned, and a deduction, unaccompanied by offsetting gains, from the volume of European production which is now available for European consumption.

INTER-ALLY PAYMENTS AND THE AMERICAN TREASURY

The importance to the American Treasury of these governmental payments from Europe is not inconsiderable. At present they amount to nearly 6 per cent of our total ordinary receipts, and if a continuance of the present levels of American prices and money incomes should be accompanied by a persistently lower yield of American taxation, their importance would doubtless grow.

Nevertheless, the connection between the debt payments and the American tax rate

is not nearly so great as is ordinarily supposed. By law, payment against the principal of the inter-Ally debts must be applied to the reduction of our federal debt—not to a direct reduction of taxation.⁴³ Moreover, while interest payments on these debts may be used for meeting current expenditure, debtor governments may make their interest payments, with certain exceptions, in obligations of our government, with the result that the public debt is thereby reduced.⁴⁴

In the eleven years from June 30, 1919 to June 30, 1930, the United States received from foreign governments 2,391 million dollars, of which approximately 1,487 million went automatically to pay off the foreign debt.⁴⁵ In theory, the difference, amounting to 904 million, was available to meet current expenditures. But this sum was far exceeded by the surplus proceeds of domestic taxation available for reduction of the public debt during this period, amounting to nearly 6,646 million dollars. In all, a total debt reduction of nearly 9,300 million was effected. Thus, even if the entire payments on the inter-Ally debts, amounting to 2,391 million dollars, had been applied to the reduction of the United States debt, there would still have remained nearly 7,000 million provided by the American taxpayer. It is clear, therefore, that to date the payments from foreign governments have gone to reduce the public debt and not to relieve the burden of the American taxpayer.

AMERICAN DEBT RETIREMENT

In the past eleven years the debt of the United States has been paid out of three main sources—sinking fund, foreign repayments and surplus of ordinary budget receipts.⁴⁶ Because of the current depression, the surplus of receipts which the United

43. First Liberty bond act (65th Congress, H.R. 2762), sec. 3; Second Liberty bond act (65th Congress, H.R. 5901), sec. 3. Cf. U. S. Treasury Department, *Report of the Secretary of the Treasury, 1917*, p. 84, 93; also, *ibid.*, 1930, p. 59.

44. When interest payments are made in obligations of our government, these obligations are receivable at par. Until December 1930 foreign governments were able to purchase United States obligations under par and hence paid their interest with these securities. Since then, however, American bonds have been high, and interest payments have been made in cash for the most part.

45. Cf. United States Treasury Department, *Report of the Secretary of the Treasury, 1930* (Washington, Government Printing Office, 1930), p. 50, 592, 608. Before June 30, 1919, \$7,921,700 was received in foreign repayments and applied to retirement of our debt. (Cf. *ibid.*, p. 592.) Thus the total non-discretionary debt retirement from foreign repayments to June 30, 1930 was roughly 1,496 million dollars.

46. The sums applied toward debt retirement from these three main sources may be tabulated as follows:

States has had since 1920 will give way this year to a large current deficit. As long as the deficit persists, debt retirements from surplus receipts will of course be impossible. In addition, in so far as the inter-Ally debtors elect to make their interest payments in cash—as is now happening, and as seems likely to be the case for some time to come—these payments can also be applied to ordinary current expenditure. As long as the American government's ordinary receipts, apart from these interest payments, fall short of ordinary expenditures, any further reductions in the inter-Ally debts would evidently increase the burden on the American taxpayer to a corresponding degree, or would necessitate a reduction in expenditure.

It is safe to assume, however, that the present federal deficit will eventually disappear, as business revives, and will once more be replaced by large surpluses. When that happens, it will then be possible to resume the retiring of the public debt out of surplus ordinary receipts and inter-Ally debt interest payments. Indeed, one Treasury official has recently expressed the opinion that the retirement of the entire war debt will be completed by 1949.⁴⁸ The payments we receive from the Allied governments after 1949, until their cessation in 1988, will then represent clear gain to us so far as concerns our public debt position. When that situation develops, the United States may well wish to consider the desirability of receiving further payments against the war debts.

INTERGOVERNMENTAL PAYMENTS AND THE PRICE LEVEL

One other economic aspect of the European governmental obligations to us requires mention. When the debt-funding agreements were made, the United States insisted on repayment of the full nominal principal of the various debts, but consented to extensive reductions in the interest charges, which actually operated to scale down the real value of the obligations themselves. Figured at 5 per cent compound interest, the average nominal reduction amounted roughly to 42 per cent.⁴⁹ General prices, however, are now a good deal lower than they were at the time the debts were contracted and the proceeds spent, and have been for some time. That is, the value of money is higher. The decline in wholesale commodity prices since 1917-1918 now amounts roughly to 37 or 38 per cent. If we choose to consider not the nominal money totals of the debts, but the real economic burdens which they entail, the decline in prices (or the rise in the value of money) has therefore offset more than four-fifths of the average reduction granted by the United States; and in the case of Great Britain and certain other countries, the remaining real burden has actually been increased. This change in real burdens, similar to that which now confronts Germany, is one from which all debtors suffer in times of declining prices. It is significant that under such circumstances what the debtor loses the creditor gains.

INTERGOVERNMENTAL PAYMENTS AND REPARATION

The general economic position of the intergovernmental obligations as they stand

| MAIN SOURCES OF DEBT RETIREMENT (For fiscal years 1920 to 1930) | | | |
|--|--------------|---------------------|-----------------|
| | Sinking Fund | Foreign Repayments | |
| | | Surplus of Receipts | |
| June 30 | \$ | \$ | |
| 1920 | | 72,669,700 | 212,475,197 |
| 1921 | 261,100,250 | 73,939,300 | 86,723,772 |
| 1922 | 276,046,000 | 64,837,900 | 313,801,651 |
| 1923 | 284,018,800 | 100,892,950 | 309,657,460 |
| 1924 | 295,987,350 | 149,387,600 | 505,366,986 |
| 1925 | 306,308,400 | 159,179,600 | 250,505,238 |
| 1926 | 317,091,750 | 169,653,500 | 377,767,817 |
| 1927 | 333,528,400 | 179,216,300 | 635,809,922 |
| 1928 | 354,741,300 | 181,804,050 | 398,828,281 |
| 1929 | 370,277,100 | 176,213,500 | 184,787,935 |
| 1930 | 388,368,950 | 160,925,850 | 183,789,215 |
| Totals | | \$3,187,468,300 | \$1,488,720,250 |
| | | | \$3,459,412,574 |

Compiled from *Report of the Secretary of the Treasury, 1930*, cited, p. 592.

47. Cf. Ogden L. Mills, "Reducing the Nation's Debt: 8 Billion Cut in Decade," *New York Times*, November 2, 1930.

today is now clear. The heart and center of the existing structure is Germany. As long as Germany makes the payments scheduled under the Young Plan, the European Allies will receive enough to meet their own payments to the United States, and in addition, until 1966, a considerable surplus for their own use. Further, the Allies are in largest part simply channels for transmitting the bulk of these payments to the United States. So far as concerns their

48. For a discussion of other computations at different interest rates, cf. Lewis Webster Jones, "The United States and the War Debts," F. P. A. *Information Service*, Vol. III, Special Supplement No. 1, p. 19-21.

intergovernmental financial relations, they will remain unaffected by business depressions, foreign exchange problems, and the fight for export markets, as long as the German payments continue. The enduring economic strains under which most of them are laboring will continue to be essentially domestic problems under these circumstances. The present intergovernmental payment situation, therefore, reduces to terms of Germany as the principal net debtor, and the United States as the principal net creditor.

The economic position of Germany at present is compounded of favorable and unfavorable factors, with the latter predominating. The depression has hit Germany as hard as any country; prices and production and most classes of money income have fallen severely; unemployment is enormous; and the federal finances have encountered a long series of crises. On the other hand, the trade balance is favorable and large, at least for the time being, and the financial program of the government is sound and strong.

THE UNDERLYING STRAIN IN GERMANY'S POSITION

When the depression is gone, however, the underlying strain in Germany's general international position will still remain, and will prove to have been but little changed by recent developments. This strain comes from the inevitable conflict between Germany's obligation to make continuous large payments abroad against public and private obligations, on the one hand; and on the other, its high dependence on foreign raw materials and foodstuffs, and the consequent need of large export markets if it is to produce and live at all. Up to now, Germany has had to maintain the balance between these conflicting forces by foreign borrowing, although it is a hopeful sign that on the average the volume of this borrowing is steadily declining in consequence of the growth in Germany's own economic strength. As long as additional foreign borrowing remains necessary, the international financial burden on Germany must inevitably grow.

Finally, if prices and money incomes become stabilized at or near present levels, the

real burden of the reparation obligations on Germany will be found to have increased in proportion. Question may then arise as to whether Germany can reasonably be asked to carry the increased load; and if a negative answer is reached, similar questions will arise inevitably concerning the inter-ally debts.

THE FUTURE OF THE INTERGOVERNMENTAL PAYMENTS

What will actually happen to the intergovernmental payments in future years depends partly on political considerations and partly on the course of world trade. If world production and trade recover fairly rapidly, and if the recovery leads to a new era of solidly grounded expansion, accompanied by stable or rising prices, then all these payment problems are likely to drop into the background. If this hoped-for growth fails to materialize, on the other hand, and especially if world prices stay low or drop further, the real burden of the intergovernmental obligations will increase automatically, since the size of the scheduled annual payments themselves increases for many years to come. A point may then be reached when purely economic factors will force a reconsideration of the whole situation. But this latter condition seems unlikely to develop either suddenly, or in the very near future.

The political aspect of the intergovernmental obligations reduces largely to terms of America and American statesmanship. It is unlikely that the European Allies, in view of their strained finances and political commitments, will be either willing or able to make large additional net concessions to Germany on reparation account. On the other hand, a special memorandum of the principal creditor powers and of Germany, signed concurrently but not as part of the Young Plan itself, provides that out of any reduction which the United States may later make in its claims against the European Allies, two-thirds of the benefit shall be passed on to Germany until 1966; and thereafter all the benefit.⁴⁹ Should the

⁴⁹ Cf. Arrangement Relating to the Concurrent Memorandum Accompanying the Experts' Plans of 7th June, 1929, Agreements Concluded at the Hague Conference, January, 1930 (London, H. M. Stationery Office, 1930), Cmd. 3484, p. 129-133.

anticipated world trade revival fail to reach satisfactory proportions, it may therefore easily become of great practical importance to the United States to reconsider the question of its claims against the European Allies. If ethical factors be disregarded, the material issue is clearly drawn. It is the question of whether the expansion in European trade and the probable resulting increase in American exports, which a further reduction in our claims would presumably entail, would yield us gains great enough to offset the accompanying direct losses to the American Treasury. On that question competent authorities disagree, however, and no answer will be attempted here.

The United States might elect, instead, to give an indirect form of relief to the foreign debtors by reducing the existing levels of the American tariff, which now bears so heavily on the international payment mechanism. Such a reduction could be advocated convincingly, however, only if it were to be accompanied by similar reductions in other high-tariff countries. The immediate prospects in these directions, either at home or abroad, evidently are not encouraging. But the passage of time may well alter the situation, both by shifting the present apparent material interests of the several countries, and by stimulating the growth of a broader understanding of the world's most critical economic problems.

PRESIDENT HOOVER'S DEBTS SUSPENSION PROPOSAL, JUNE 20, 1931*

The American Government proposes the postponement during one year of all payments on intergovernmental debts, reparations and relief debts, both principal and interest, of course, not including obligations of governments held by private parties. Subject to confirmation by Congress, the American Government will postpone all payments upon the debts of foreign governments to the American Government payable during the fiscal year beginning July 1, next, conditional on a like postponement for one year of all payments on intergovernmental debts owing the important creditor powers.

* * *

The purpose of this action is to give the forthcoming year to the economic recovery of the world and to help free the recuperative forces already in motion in the United States from retarding influences from abroad.

The world-wide depression has affected the countries of Europe more severely than our own. Some of these countries are feeling to a serious extent the drain of this depression on national economy. The fabric of intergovernmental debts, supportable in normal times, weighs heavily in the midst of this depression.

From a variety of causes arising out of the depression, such as the fall in the price of foreign commodities and the lack of confidence in economic and political stability abroad there is an abnormal movement of gold into the United States which is lowering the credit stability of many foreign countries. These and the other difficulties abroad diminish buying power for our exports and in a measure are the cause of our continued unemployment and continued lower prices to our farmers.

Wise and timely action should contribute to relieve the pressure of these adverse forces in foreign countries and should assist in the re-establishment of confidence, thus forwarding political peace and economic stability in the world.

Authority of the President to deal with this problem is limited, as this action must be supported by the Congress. It has been assured the cordial support of leading members of both parties in the Senate and the House. The essence of this proposition is to give time to permit debtor governments to recover their national prosperity. I am suggesting

to the American people that they be wise creditors in their own interest and be good neighbors.

I wish to take this occasion also to frankly state my views upon our relations to German reparations and the debts owed to us by the allied governments of Europe. Our government has not been a party to, or exercised any voice in, domination of reparation obligations. We purposely did not participate in either general reparations or the division of colonies or property. The repayment of debts due to us from the Allies for the advances for war and reconstruction was settled upon a basis not contingent upon German reparations or related thereto. Therefore, reparations is necessarily wholly a European problem with which we have no relation.

I do not approve in any remote sense of the cancellation of the debts to us. World confidence would not be enhanced by such action. None of our debtor nations has ever suggested it. But as the basis of the settlement of these debts was the capacity under normal conditions of the debtor to pay, we should be consistent with our own policies and principles if we take into account the abnormal situation now existing in the world. I am sure the American people have no desire to attempt to extract any sum beyond the capacity of any debtor to pay, and it is our view that broad vision requires that our government should recognize the situation as it exists.

This course of action is entirely consistent with the policy which we have hitherto pursued. We are not involved in the discussion of strictly European problems, of which the payment of German reparations is one. It represents our willingness to make a contribution to the early restoration of world prosperity, in which our own people have so deep an interest.

I wish further to add that while this action has no bearing on the conference for limitation of land armaments to be held next February, inasmuch as the burden of competitive armaments has contributed to bring about this depression, we trust that by this evidence of our desire to assist we shall have contributed to the good-will which is so necessary to the solution of this major question.

*New York Times, June 21, 1931.

TEXT OF FRANCO-AMERICAN WAR DEBT ACCORD, JULY 6, 1931†

After an exchange of views the French Government states that it is in agreement with the United States on the essential principle of President Hoover's proposal and on the following propositions, which may be expressed thus:

1. The payment of intergovernmental debts is postponed from July 1, 1931, to June 30, 1932.
2. However, the Reich will pay the amount of unconditional annuity. The French Government agrees, in so far as it is concerned, that the payments thus made by the Reich shall be placed by the Bank for International Settlements in guaranteed bonds of the German railroads.
3. All suspended payments shall be subject to interest in accordance with the conditions suggested by the American Government, payable in ten annual instalments beginning with July 1, 1933.
4. The same conditions shall apply to the bonds to be issued by the German railroads. On the three points which it is recognized do not directly concern the American Government the French Government makes the following observations:

(A) A common action by the principal central banks acting through the medium of the Bank for International Settlements shall be organized to assist the countries of Europe which would be particularly affected by the postponement of the payment as proposed.

(B) A preliminary understanding should take place between France and the Bank for International Settlements in order that France shall not supply the guarantee fund provided for in the Young Plan in the event of a moratorium except by monthly payments in accordance with the needs of the Bank for International Settlements after actual transfer of payments by Germany.

(C) The question of deliveries in kind and the various modifications which will become necessary as a result of the application of the American proposal and the present agreement shall be studied by a committee of experts named by the interested powers, which shall reconcile the material necessities with the spirit of President Hoover's proposal. France reserves the right to request of the German Government indispensable assurances concerning the utilization for exclusively economic purposes of the sums freed to the Reich budget.

TEXT OF LONDON COMMUNIQUE, JULY 23, 1931‡

The recent excessive withdrawals of capital from Germany have created an acute financial crisis. These withdrawals have been caused by a lack of confidence which is not justified by the economic and budgetary situation of the country.

In order to insure maintenance of the financial stability of Germany, which is essential in the interests of the whole world, the governments represented at the conference are ready to cooperate so far as lies within their power to restore confidence.

The governments represented at the conference are ready to recommend for the consideration of the financial institutions in their respective countries the following proposals for relieving the immediate situation:

First, that the central bank credit of \$100,000,000 recently granted to the Reichsbank under the auspices of the Bank for International Settlements be renewed at maturity for a period of three months.

Secondly, that concerted measures should be taken by the financial institutions in the different countries with a view to maintaining the volume of credits they have already extended to Germany.

The conference recommends that the Bank for International Settlements should be invited to set up without delay a committee of representatives nominated by the governors of the central banks interested to inquire into the immediate further credit needs of Germany and to study the possibilities of converting a portion of the short-time credits into long-term credits.

The conference noted with interest a communication from Dr. Brüning relative to the joint guarantee recently placed by German industry at the disposal of the Gold Discount Bank. The conference is of the opinion a guarantee of this description should make it possible to provide a sound basis for the resumption of normal operations of international credit.

The conference considers that if these measures are carried through they will form a basis for more permanent action to follow.

The conference also decided that a committee of experts should proceed with an elaboration of the detailed measures required for giving effect to President Hoover's proposal for a year's suspension of intergovernmental debts.

†*Ibid.* July 7, 1931.

‡*Ibid.* July 24, 1931.